

providers will increasingly transition to the influx of new PCS wireless capacity by late 1996, leading us to look for an emphasis on better targeted marketing programs, reduced churn, packaging of long distance and wireless, and improved costs per gross addition as incumbent wireless providers seek to balance subscriber growth with higher profitability targets. We recommend **AirTouch**, our only pure wireless play, and **U S West Media**, both with an expanding domestic and international footprint.

***We believe aggressive network expansions will enhance the position of the competitive access providers***

**Competitive Providers** - For the rest of 1996 and beyond, this industry segment will continue to be focused on robust revenue growth as local markets continue to open, with cash flow losses expected to trend downward. The group will benefit from the implementation of co-carrier agreements that result from federal legislation and state regulatory momentum. MFS Communications, for example, has already signed a co-carrier agreement with Ameritech, which physically links their networks and allows transferring of calls between the two companies' customers. **We expect these companies to maintain their robust revenue growth as they continue to build out their networks in new and existing markets.** These companies will continue to benefit from providing their customer bases with increased efficiencies through frame relay service offerings, for example. **Our Buy rated CAPs include: MFS Communications and Intermedia Communications.**

## Purchase Recommendations

***AIT is favorably positioned to increase earnings through internal growth and entry into new markets***

**Ameritech.** We reiterate our Buy rating, viewing AIT as favorably positioned to generate strong growth in its core businesses and enter new markets — security monitoring, new information services contracts, long distance, and video — enabling AIT to sustain its accelerated 10% revenue growth rate. We look for AIT to be one of the earliest RHCs to enter long distance within its region as it will be able to satisfy the competitive checklist relatively early. We believe the AIT shares deserve a premium valuation given their accelerated revenue growth and reduced cost structure, translating into consistent double-digit EPS growth and strong dividend growth. **We continue to expect strong revenue growth in 1996, in line with AIT's targeted double-digit levels, reflecting:** relatively consistent volume trends (assuming no dramatic decline in the economy); benefits from AIT's greater exposure to faster growing businesses, notably security monitoring (10%-12% growth) and an influx of contract contributions; no impact from long distance entry (expected in late 1996-97); and more modest price reductions than in 1995. From an earnings perspective, we look for about 10% growth in 1996 and 1997. We point to our six- to twelve-month price objective of \$71 per share based on a 10% premium to the market multiple on our 1996 earnings estimate.

***Although a BEL/NYN merger will form a powerful combination, BEL's strong fundamentals and leadership position are most compelling***

**Bell Atlantic.** On April 22nd, BEL/NYN announced a definitive agreement for a merger, which will form a powerful combination based on their domestic and global market presence in local, long distance, wireless, and video. We believe the resulting combination will have higher growth potential than the current 7%-10% EPS growth that each company has been targeting on a stand-alone basis. While the combined company will realize

initial "hard" costs of the Bell/NYN merger. Over a range over three years, we see the impetus behind the merger as a means for leveraging a common platform, complementary services, and marketing synergies to provide an expanded customer base with "first best in practice" products and services. The combined BEL/NYN will likely be more successful in capturing a significant share of new revenue opportunities, notably long distance, video, and electronic commerce, than either could likely achieve on a stand-alone basis as well as minimizing share loss. Longer term, we expect the combined company to be a formidable player in each of these larger addressable markets.

Although we expect the BEL/NYN merger to occur, it is difficult to predict regulatory and legal hurdles in the new telecom environment. We anticipate significant scrutiny, especially given the perceived elimination of a competitor. On a stand-alone basis we believe BEL's strong fundamentals and leadership position for offering new services is compelling. We have strong confidence in BEL's management's ability to target growth opportunities, offsetting both competitive pressures on pricing and expected dilutive effects of fledgling businesses with its strong marketing focus. This is while BEL keeps a keen eye on cost containment efforts. **We continue to believe that BEL's long-term commitment to superior strategic positioning in its markets, accelerating revenue growth targets, and its lower-cost structure will enable it to grow at the upper end of its peers' average growth rate.** We target an \$80 price objective within twelve months, based on at least a 10% premium to the market P/E on our 1996 earnings estimate.

***GTE should benefit as the first large telco to offer integrated services to its large customer base***

**GTE Corporation.** Our outlook for GTE is positive based on its unique position in the industry and above-average fundamentals in its telco business, which should face lower rate cuts in future quarters as its prices move more in line with competitive needs. In addition to the strength of its core telco business, we look for new growth opportunities in long distance, video, and international to enhance GTE's earnings growth in the future. We anticipate GTE will produce at least 10% earnings growth in 1996 and 1997, inclusive of market share loss from competition. With the lifting of its consent decree (which differs from that of the RHC's), GTE has re-entered the long distance markets, now offering service in eleven states. Service is being provided through a resale agreement with WCOM. For GTE, long distance represents a \$4.8 billion market opportunity, or \$3.5 billion net of access costs, within its local territories. The company expects to offer long distance service in all twenty-eight of its states by the end of 1996. The \$3.5 billion interlata long distance opportunity compares to a \$1.6 billion risk of increased competition in its intralata toll market. **With the ability to offer long distance, we expect GTE to achieve an early national integrated services strategy, packaging wired, wireless, long distance, and video services for its existing large customer base. GTE is in a unique position and able to achieve such a strategy sooner than most of its peers. We reiterate our Buy recommendation, pointing to a higher price target of \$54 per share based on a 10% premium to the market P/E multiple on our 1996 earnings estimate.**

*Driven by international operations, our forecasts call for long-term growth in earnings and cash flow of 25%-30%*

**AirTouch Communications** AT&T is one of the best-positioned global wireless companies, with strong growth in its domestic cellular and paging businesses, robust growth in its international markets, and, excluding start-ups, a swing to profitability in its international systems. Domestically, AT&T recently announced the rollout of CDMA digital service in its Los Angeles market. While we had expected this announcement, it confirmed our view that AT&T is on the forefront of digital technology and better positioned to offer its high-usage cellular customers with enhanced (higher margin) services. While AT&T's domestic business is its current strength, its engine of growth lies overseas. Our forecasts call for long-term growth in earnings and cash flow of 25%-30%, with a larger contribution from international operations. Furthermore, we believe AT&T shares will benefit from higher values accorded to its international wireless businesses as they improve in profitability in 1996 (excluding start-ups) and become a greater contributor to subscriber, cash flow, and earnings growth. We would point out that AT&T's cellular networks in Germany, Belgium, and Portugal are currently generating positive net earnings, with Germany generating operating cash flow margins in excess of 40%. AT&T's international wireless businesses now account for over two-thirds of the company's total global pops, and will provide nearly half of AT&T's new customers in 1996 and about 40% of proportionate revenues. However, we estimate that these businesses account for only about a third of AT&T's current value, a level expected to move up to at least 40%-50% as these businesses ramp up with robust growth rates. **Based on our sum-of-the-parts valuation, we target at least a \$40 price objective in the six- to twelve-month time frame.**

*We believe AT&T will emerge as a powerful integrated service provider with the best brand name globally*

**AT&T.** We reiterate our Buy rating on AT&T shares based on the company's strong positioning in the global information industry, and our favorable outlook on the proposed break-up of AT&T's business into three publicly traded companies. We believe the break-up will enable AT&T's respective businesses to achieve higher growth, greater profitability, and ultimately higher valuations, as management will have more flexibility to run the businesses without internal conflicts. **Importantly, we feel that the greater focus within the "new AT&T" will provide greater offensive (getting into local service) and defensive (preventing market share loss) strategies, as the RHCs enter long distance.** We also believe that AT&T is well positioned to benefit from increased local competition, including its own entry into local markets, driving down its access costs. Longer term, we see AT&T emerging as a powerful integrated service provider with perhaps the strongest brand name globally. Despite the potential for investor concerns regarding increased competition, we believe the evolution towards more exciting integrated services has begun, with movement away from the merely commodity-oriented nature of the industry. As part of a bundled package, AT&T's planned expansion of its Worldnet Service to provide customers with free access to the Internet should enhance its long distance customer retention. Over 150,000 customers have signed up for the new service with continued strong demand. **Based on our sum of the parts valuation, we target an \$80 price objective in twelve months, based on \$68-\$70 per share for AT&T Communications, plus over \$12 for its soon to be sold or spun-off businesses, Lucent Technologies, NCR, and AT&T Capital.**

***FRO should benefit from accelerated growth, strong finances, and its position as a national integrated service provider***

***We believe ICIX's strategy, particularly in frame relay, is working well, allowing ICIX to come into it own with favorable growth prospects***

***New business ventures are contributing strong revenue growth and enhancing MCIC's long distance business with direct links to its customers***

**Frontier Corporation.** We reiterate our Strong Buy recommendation on FRO shares based on several unique attributes: (1) an accelerated growth rate through recent long distance acquisitions from its stand-alone level, with the faster growing long distance now providing 75% of its total revenues and giving FRO a national platform and customer base; (2) its early position as a national integrated service provider (FRO is one of the few companies able to jointly market services under federal legislation because its market share is below 5% and has been doing so for about two years in some capacity); (3) its enhanced takeover/partnership appeal; (4) its strong financial position with a relatively low debt ratio, giving it financial flexibility; and (5) it combines growth stock attributes, a respectable dividend yield, and trades at an attractive P/E multiple, not yet reflecting our expectations for at least high-teens growth. **We point to a price target of \$40, which we believe is achievable over the next twelve months, based on a 25% premium to the market P/E multiple on our 1997 earnings estimate of \$2.00 per share, which should be viewed as conservative.**

**Intermedia Communications.** We believe ICIX to be one of the better-positioned companies in its industry segment. ICIX is currently undertaking an aggressive vertical and geographic expansion throughout the Southeast. This is causing near- to intermediate-term operating cash flow losses, and requiring the company to tap the financial markets through recently completed debt and equity offerings. The capital infusion will be used to carry out ICIX's aggressive growth strategy, and by offering debt with equity improves ICIX's debt/total capital ratio. We believe ICIX's expansion strategy, strong growth in data services, improved regulatory outlook at both federal and state (Florida) legislation, and impending entry into switched services (switches in Tampa and Miami were formally inaugurated on June 4th and June 6th respectively), will further bolster its offerings along with enhanced transport services, long distance, special access, and systems integration services. Overall, we believe ICIX's strategy, particularly in the frame relay market, is working well, allowing ICIX to come into its own with favorable growth prospects. The acquisition of EMI enhances this strategy by bringing \$45-\$50 million in annualized revenues, of which 80%-90% are data services related. We expect operating cash flow losses to continue through most of 1997 before they breakeven in 4Q97, but should ramp-up considerably thereafter. **Our price target for ICIX shares is \$44 per share, based on our discounted cash flow analysis using a 12 multiple on our \$141 million estimate for year 2000 operating cash flow and a 21% discount factor.**

**MCI Communications.** MCIC has clearly demonstrated its ability to move quickly and early in a rapidly changing environment. New business ventures and alliances, such as the acquisitions of SHL Systemhouse and Nationwide cellular, an investment in and partnership with News Corp. (NWS-Buy-21<sup>7/8</sup>), and the introduction of MCI One, its first true integrated package, are resulting in a far stronger MCIC in terms of providing stronger links with its customers and better service packaging and solutions. We have increased confidence in these types of strategic initiatives, which favorably position MCIC in the changing landscape. **MCIC's growth opportunities**

associated with more open markets outweigh the risk of RHC entry into the long distance market in our opinion. We reiterate our Buy recommendation, believing that MCIC's shares do not fully reflect the values for some of its new businesses (wireless, local, systems integration, and most recently DBS). Collectively, these could command \$8-\$10 per share in addition to its strong long distance business valued in the mid \$30s (using a 15-16 multiple on 1996 EPS). **Based on our sum-of-the-parts analysis, our six- to twelve-month price target is at least \$40.**

***MFST's planned merger with UUNET is a natural fit with its expansion strategy and robust network platform***

**MFS Communications.** MFST's corporate and regulatory initiatives, including the development of its growth businesses such as Intelenet and International, and the lifting of regulatory barriers (particularly co-carrier issues — reciprocal compensation, local number portability) through federal legislation, should result in a larger addressable market and higher margins by the end of the decade than our earlier forecast. As a national player, and one of the earliest positioned competitors offering integrated services, MFST is likely to be among the largest beneficiaries of an increasingly open local exchange market and an attractive partner for other players. Furthermore, MFST has announced plans to merge with UUNET, an Internet-service provider. We view this merger as a natural fit with MFST's expanding strategy and robust network platform, extending its reach worldwide for offering Internet-related services. To a great degree this deal signifies a belief that the telecom industry is transitioning from a traditional circuit-based network architecture to a Internet Protocol based network utilizing packet switching architecture. **Assuming a conservative 30% operating cash flow margins MFST, inclusive of UUNT's cash flow will generate \$1.5 billion in operating cash flow in the year 2000. This translates into a \$50-\$55 price per MFST share in 12-18 months, a step up from our \$45-\$50 stand-alone price target, and reflects the expanded share base to about 183 million shares following this transaction.**

***We have increased confidence in our Buy recommendation which had been linked to our Buy on SBC based on the specific terms of the deal***

**Pacific Telesis.** A better than expected first quarter earnings report has strengthened our Buy recommendation for PAC shares on a stand-alone basis (i.e., if the merger with SBC were not completed) as well as validates SBC's merger proposal which looks more savvy. We have increased confidence in our Buy recommendation on the PAC shares, which had been linked to our Buy on SBC based on the specific terms of the deal. The better than expected earnings report from PAC more clearly justifies the premium SBC was willing to pay (40% premium on pre-merger depressed share price) though the magnitude of PAC's earnings improvement, if sustainable, allows us to speculate that our post-merger 1997 estimate of \$3.60 per share for SBC, inclusive of dilutive effects, may prove to be quite conservative.

***SBC gains complementary benefits from the merger which will enhance its competitive position and longer-term growth***

**SBC Communications.** We had upgraded our estimate for SBC to a Buy after the announced acquisition of Pacific Telesis, citing two reasons for the upgrade. First, since the announcement, SBC shares are trading at a discount to their peers (14.5 times 1996 revised EPS compared to 14.6 times on average) in contrast to their historical premium. We believe that it is at an attractive valuation relative to its above-average earnings growth. Second, we have a favorable outlook on the merger with PAC, which though dilutive to 1997 earnings, will provide for higher growth prospects longer term. We

believe that SBC gains complementary benefits from the merger that will enhance its competitive position. In addition SBC should benefit from PAC's expertise in controlling costs and bringing prices down to more competitive levels. We see higher growth opportunities as a result of the merger through PAC's two PCS licenses in California, an area that SBC's cellular footprint does not cover, and through greater access to international calling. Our Buy rating was reaffirmed as a result of SBC's strong first quarter 1996 results. **Assuming the merger agreement is completed by year-end, we target a \$63 price objective in the next twelve months.**

**U S West Media.** We have a positive view of UMG's strategy for growing its businesses, both internally and through acquisitions. UMG's recent initiatives – the pending Continental Cablevision acquisition, domestic wireless expansion through its cellular merger with AirTouch and development of PCS networks, and international wireless expansion – represent a good strategic and geographic fit with UMG's existing businesses. The definitive agreement to acquire Continental Cablevision, the third-largest U.S. cable operator, positions UMG as a formidable player in the domestic cable industry and complements MediaOne, its Atlanta cable operation. On the domestic wireless front, UMG intends to complete phase II of its merger with AirTouch in the fourth quarter 1996, creating a 58 million pop footprint. In addition, through PrimeCo Personal Communications, UMG is targeting the build out of PCS networks in eleven key markets by year-end that will fill in the national wireless footprint of the respective companies involved (UMG/ATI/BEL/NYN). Internationally, UMG will continue building out networks in start-up markets (Poland, Malaysia, Indonesia, India), while its Mercury One-2-One unit is accelerating its expansion plans and now intends to double its coverage of the U.K. population by the end of 1996.

***We target a \$26-\$30 per share value in 12 months for UMG's various businesses***

Although many of UMG's strategic plans will likely be dilutive to earnings in 1996 and 1997 (already incorporated into our estimates), they position UMG for continued strong revenue and subscriber growth longer term. **Collectively, we believe UMG's various businesses, inclusive of Continental Cablevision, are worth at least \$26-\$30 per share.** We utilize two valuation methods. First, using a 10-10.5 multiple on our \$2.5-\$2.6 billion estimate for 1997 proportionate operating cash flow and backing out about \$10.4 billion in pro forma net debt (inclusive of the Continental Cablevision acquisition), we project a \$26-\$28 target price. Second, and supporting the first valuation, is our detailed sum-of-the-parts valuation, which yields a \$26-\$30 price after a 15% discount for targeted stock versus a spun off company. Based on the average of our valuations, we see at least 40% price appreciation in the next twelve months for the UMG shares from current levels.

***WCOM projects 30% annualized earnings growth through 2000***

**WorldCom, Inc.** Strong first quarter results reported by WCOM have further reinforced our positive view of this company, which is well positioned in fast growing segments of the industry. With an established low-cost structure, WCOM should be able to at least maintain its above-average earnings growth throughout the rest of the decade as it emphasizes growing

its revenue base across key industry segments, including: wholesale, private line, commercial, data and international.

We believe WCOM remains on track to deliver better than 20% revenue growth, some margin improvement, and debt de-leveraging, which should translate into better than 30% long-term earnings growth through the year 2000. We are confident that WCOM will attain or exceed these targeted levels of growth. WCOM's outlook is extremely strong, with an upside surprise potential likely to provide an even brighter outlook. First, revenue growth from core businesses should trend ahead of 20% (with the year-to-year negative comparison for operator services less onerous in the second half of 1996), with wholesale revenues from new contracts ramping up in 1997 and beyond. On the cost side, we see WCOM's high level of goodwill amortization, which reduces 1996 EPS by as much as one-third, beginning to decline to 20%-25% of 1997 EPS. This goodwill stems from two large acquisitions over the past two years (MetroMedia and Wiltel) done on a purchase accounting basis rather than a pooling-of-interest basis typical of its other acquisitions. WCOM's goodwill could always be written off in one period rather than over the full-time period. WCOM could write off the full amount related to the acquisitions, or more appropriately, additional amounts associated with underperforming or non-core assets. This possibility is *not* in our estimate. **Given WCOM's 30% earnings growth, sustainable through the year 2000 based on achievable assumptions, we believe the shares warrant a multiple revaluation to the mid- to high 20s on our 1997 earnings estimate. Therefore, we would target a \$60-\$65 price objective in a twelve-month time frame.**

*Conservatively, we maintain a \$60-\$65 price target over the next twelve months*

## Upcoming Events

### Update on U S West Media/Time Warner Lawsuit

*Oral arguments began May 15; we expect a court decision by June 15*

An event we are monitoring closely is the respective lawsuits between U S West Media and Time Warner Entertainment (TWE). We look for the FTC to render a decision on Time Warner's (TWX-42-Buy) purchase of Turner Broadcasting Systems in the next few months, which could have implications for a UMG/TWE settlement. Staff members at the FTC have recommended that the commission block the acquisition of Turner by TWX on the grounds that it would consolidate too many premium cable channels, but the FTC's final action is still uncertain. On May 6 UMG and TWX completed oral arguments regarding their lawsuit, with a court decision (if necessary) expected by June 15. While disappointed that a resolution has not already been reached, we are comforted by the fact that its has not impacted the goal of growing their cable businesses and upgrading their networks for offering telephony and interactive services to generate higher growth potential longer term.

## Implementation of the Telecom Act of 1996

*The FCC is seeking comment and guidance from all players, recognizing the gray areas in the Telecom Act*

With passage long completed, the difficult task of implementation has begun. On April 19th, the FCC released the first major Notice of Proposed Rulemaking (NPRM) regarding the implementation of the local competition provisions in the Telecommunications Act of 1996. Essentially, the NPRM provides a national framework for interconnection rules, requiring incumbent local exchange companies (LECs) to offer interconnection, unbundled network elements, transport and termination, and wholesale rates for retail service to new entrants.

In its NPRM, the FCC established that technical interconnection points are considered feasible if the LEC is already providing it now or has in the past, therefore making these points available upon request. It has also mandated that interconnection agreements must be just, reasonable, and nondiscriminatory in terms and conditions and in whether interconnection is equal in quality to what the LEC provides itself. On network unbundling, the FCC addressed access to unbundled elements offered by the LECs to competitors based on only their specific needs and at reasonable cost-based pricing. The FCC tentatively concluded that it should identify a minimum set of network elements along four categories (loops, switches, transport facilities, signalling and databases) with definition to evolve as requirements change.

The FCC has solicited feedback from industry participants on the main issues, specifically:

- whether to require states to use long-run incremental cost formulas;
- whether to set a national cap on local interconnection service rates, with states permitted to set rates below the ceiling but never above it;
- whether charges should be flat rate or usage sensitive;
- whether it should allow inclusion of embedded cost and universal service subsidies in rates for local interconnection services;
- whether states should be allowed to require additional unbundling; and,
- whether a competitor can recombine unbundled network elements to replicate a service the telco offers for resale, and what safeguards are needed to prevent telco discrimination.

Given the number of comments sought by the FCC, it is difficult to reach a conclusion as to who is a winner or loser. It appears that the FCC's attempt at prompt interpretation would favor competitors over incumbent LECs where tentative conclusions were reached, specifically in addressing network unbundling elements. On the other hand, the FCC sends a lot of the specifics back to the states, an approach favored by the large telcos in particular. **If this is the case, as we expect it will be, then local competition will differ significantly by state or region and make it difficult to call local or long distance carriers losers by segment. This reinforces our belief that stock**



selection should be on the basis of individual company merits rather than current segment orientation. We continue to closely monitor these developments and await the upcoming decision.

## Recent Industry Developments

### Merger Mania: The Industry Realigns

*With the approach of open markets and increased competition, industry restructuring has accelerated*

With federal legislation now law, the RHCs and other companies have begun unveiling their strategies in anticipation of open markets that should unleash increased competition and growth opportunities. We have already witnessed merger announcements between two pairs of Baby Bells, AirTouch's earlier than expected merger with Cellular Communications, and U S West Media's planned acquisition of Continental Cablevision. In addition, AT&T, has sold about 17% of its Lucent Technologies equipment business through an initial public offering, with plans to spin off the remainder to shareholders, while Sprint has spun off its cellular business, now known as 360 Communications. Clearly, many of these deals were in the works before the Telecom Act of 1996 was signed, but their pace was accelerated since enactment. The proposed mergers seek better scale and scope, and a larger addressable market, which we believe will enable them to prosper from growth opportunities in the increasingly competitive environment. **While there are distinct differences between the Bell Atlantic/NYNEX and Pacific Telesis/SBC Communications transactions, the key similarities indicate that the combined companies will be better positioned from offensive and defensive viewpoints to compete on a global basis. Furthermore, the exchange of complementary skills will strengthen each company's inherent weaknesses.** We expect these deals to have significant ramifications for the industry as it adapts to the dramatic changes augmented by legislation. These two deals will likely attract substantial scrutiny from respective regulators, the FCC, the Department of Justice, et al., as concerns are raised regarding their anti-competitive potential. We will be watching for signs of delay, especially from the bi-coastal regulatory hotbeds, notably the California Public Utilities Commission (CPUC) and the New York Public Service Commission (NYPSC).

### SBC Communications/Pacific Telesis

*We see the differences between SBC and PAC creating areas of opportunity for the combined entity*

SBC announced on April 1 that it would acquire all of the shares of PAC in a stock exchange in which each PAC shareholder will receive 0.733 shares of SBC common stock. Based on prices before the announcement, SBC is paying nearly \$17 billion for PAC, a 40% premium, although we believe the premium price properly reflects PAC's intrinsic value. We view this merger positively for both companies, with enhanced growth prospects longer term. **Though to a large degree PAC and SBC are the antithesis of one another (differences include cost structures, competitive access pricing, fundamental trends such as volume growth, diversification strategies, and respective regulatory environments), we see these differences creating areas of opportunity for the combined entity.** For PAC, the deal provides the scale, scope, and financial flexibility that it currently lacks.

SBC's attraction to PAC is the exposure to the California market, PAC's two PCS licenses (Los Angeles and San Francisco) where SBC lacks a wireless presence, and the greater potential for international long distance traffic to the Pacific Rim. In addition, we see PAC management's expertise in focusing on cost containment and bringing prices closer in line with costs for a competitive advantage as an important benefit for SBC, which has lagged its peers in this respect.

Importantly, we see the potential in-region long distance opportunity for the combined company at \$10.8 billion, net of access, compared with only a \$2.2 billion risk in intralata toll revenues. Although dilutive to SBC's earnings in 1997 (we estimate by only \$0.10 per share given PAC's recent stronger results) we expect SBC to resume double-digit earnings growth by 1998, with higher growth longer term. While regulatory approvals could take time, particularly with the California Public Utility Commission (CPUC) — the wild card in the approval process — early indications are favorable that the deal will be completed close to the year-end 1996 target.

### Bell Atlantic/NYNEX

***The combined company should be successful capturing market share of new revenue opportunities, notably long distance, video, and information/entertainment***

On April 22, BEL and NYN announced a definitive agreement to merge in a \$22 billion stock transaction, with BEL shareholders receiving 1.302 shares in the new company for each existing share and NYN shareholders exchanging shares on a 1:1 basis. This merger differs from the SBC/PAC combination as it is specifically designed as a "merger of equals" of two contiguous companies that had been separated by AT&T's divestiture. The impetus behind the merger is to leverage a common platform, complementary services, and marketing synergies to provide an expanded customer base with their "best in practice" products and services. **We see the combined company being more successful in capturing significant share of new revenue opportunities, notably long distance, video, and information/entertainment, than either company could achieve alone. In addition, we believe the combination will minimize share loss in their local services businesses.** Given the existing and broad relationships between the two companies (BANM, PrimeCo Personal Communications, Tele-TV, wireless cable), we are confident that the management teams will work well together.

The long distance opportunity for the combined entity is \$20 billion, or about \$14 billion net of access, with 45% of calls both originating and terminating within their region. Further, the \$4-\$6 billion international long distance opportunity represents 35% of the total U.S. international market. As a result of the operational synergies and new growth opportunities, the combined company will have a higher growth potential of at least 10%-12%, compared with their current respective 7%-10% EPS targets on a stand-alone basis. The combined company will realize "hard" cost savings of \$600 million over three years, through consolidation of duplicate functions (i.e., data centers) and the elimination of 3,000 non-union employees. Because of the contiguous nature of their markets, and the elimination of a key potential competitor to local markets in their regions, we expect strong regulatory scrutiny of this deal. The merger is targeted to close within 12 months, but the higher regulatory hurdles could potentially delay completion beyond that time.

Table 5: How the Combined RHCs Might Look

SBC	PAC	SBC/PAC		BEL/NYN	BEL	NYN
<i>Financials</i>						
3,197	2,334	5,531	Total Revenues (\$Mil)	6,461	3,207	3,254
1,346	1,052	2,398	EBITDA (\$Mil)	2,719	1,437	1,282
42.1%	45.1%	43.6%	EBITDA Margins	42.0%	44.8%	39.4%
800	590	1,390	Operating Income (\$Mil)	1,246	808	438
25.0%	25.3%	25.1%	Operating Margins	19.3%	25.2%	13.4%
4,000	6,800	10,800	1995 In-Region Interlata Revenues (1) (Opportunity)	13,200	7,500	6,200
1,000	1,200	2,200	1995 In-Region Intralata Toll Revenue (Risk)	3,250	1,400	1,850
47%	24%	36%	1995 % of Calls Originating/Terminating In-Region (2) (3)	45%	45%	20%
<i>Operating</i>						
14,466	16,009	30,475	Access Lines (000s)	37,352	20,033	17,319
4.9%	3.9%	4.4%	Access Line Growth (YTY)	3.6%	3.5%	3.6%
14,048	15,822	29,870	Access Minutes (mil)	37,051	20,701	16,350
10.8%	10.0%	10.4%	Access Minutes Growth (YTY)	11.7%	12.7%	10.7%
46,000	NA	40,600	Owned Cellular Pops (000s) (4)	53,788	NA	NA
3,807	NA	3,807	Cellular Subscribers (000s) (4)	3,575	NA	NA
9.4%	NA	6.0%	Penetration (4)	6.4%	NA	NA
6,613	31,036	37,649	PCS Pops (4)	30,000	NA	NA
59,540	48,776	108,316	Employees	127,186	61,180	66,006
AR, CA, KS, MS, NV, OK, TX			Markets	CT, DE, MA, MD, ME, NH, NJ, NY, PA, RI, VA, VT, WV		
(1) represents interlata revenues, net of access costs, for calls that originate, but do not necessarily terminate, in-region and include areas covered by independent telcos, except for NYN.						
(2) With the exception of PAC, percentages based on calling volumes, but percentage of revenue will only be slightly different.						
(3) Combined percentage includes calls that originate in BEL's region and terminate in NYN's region, or vice versa.						
(4) Cellular operations already combined under Bell Atlantic/NYNEX Mobile.						

## MFS/UUNET

*This deal seems a natural fit with MFST's expanding strategy and robust network platform*

On April 30th MFS Communications and UUNET announced a definitive agreement to merge in a \$1.8 billion stock transaction. UUNET shareholders will receive 1.777776 shares of MFS for each share of UUNET. This first ever transaction between an Internet provider and a facilities-based local access provider should positively enhance MFST's revenue and cash flow growth. We view this as a natural fit with MFST's expanding strategy and robust network platform, extending its reach both nationally and internationally for offering Internet-related services that will enhance MFST's own Internet strategy with a national extension. Internet-related revenues now account for 25% of MFST's incremental revenue growth (at the end of last year) from modest numbers at the beginning of 1995. We believe the combined company will result in accelerated revenue and cash flow growth, with deal having positive accretive benefits in the near term.

We believe the combination creates a dominant force in the Internet segment, as it will be the first company to have a presence and control in the seven layers in the Internet Protocol stack. To a great degree this deal signifies MFST's belief that the telecom industry is transitioning increasingly from the traditional circuit-based network architecture to the Internet Protocol (IP) based networking utilizing packet switching architecture. The cost savings are enormous, with IP-based network costing 1% that of the equivalent circuit switches.

## FCC's PCS C Block Broadband Licenses Auction

*Cost per pop was significantly higher than the A and B block auctions*

Originally completed on May 6th, part of the C Block auction will reopen July 3rd. Beset by controversy from the start, the FCC has decided to reauction 17 licenses, including those covering Seattle, Phoenix, Minneapolis, Denver, and Portland, Ore., because the initial winner, BDPCS, Inc., defaulted on its initial payment. BDPCS, Inc., the 4th largest bidder, had winning bids totalling \$873.8 million but could not make the required 5% down payment by May 15th.

The PCS auction for Block C broadband licenses in the Basic Trading Areas (BTA) initially ended in early May with a total of \$10.22 billion in bids, or \$40.30 per pop, significantly higher than the \$7.7 billion, or \$15.29 per pop bid in the previous broadband PCS auction for Block A and B licenses in the Major Trading Areas (MTA). Different financial terms, deep-pocketed financial backers, and to a degree irrational bidding accounts for the high level of bids compared to the previous A/B Block auction.

The top three winners each had total bids in excess of \$1 billion. The biggest winner, NextWave Personal Communications, bid \$4.2 billion for 56 licenses including New York, Los Angeles, Washington DC, and Boston, covering about 93.8 million pops, or about \$44.80 per pop. The second biggest winner in the auction, DCR PCS Inc., a unit of DCR Communications, won 43 licenses giving it 33.6 million pops, most notably Chicago, Detroit and Dallas, for \$1.4 billion, or \$42.52 per pop. Finally, GWI PCS Inc., the third-largest dollar bidder, won 14 licenses covering 17.9 million pops, including San Francisco and Miami, for \$1.06 billion, or \$59.07 per pop.

*We look for new license holders to partner with stronger financial entities and emerge as wholesale wireless carriers*

Under the favorable payment terms, C Block winners can pay for their licenses in instalments over ten years, paying interest only for the first six years (at a rate equal to the ten-year Treasury note at the date the license is granted), followed by interest and principal payments for the next four years. With the FCC as the C Block license holders' main creditor, questions surround how they will finance their buildout. We look for the new license holders to partner with stronger financial entities as a possible alternative. We also envision national wireless resellers, such as MCIC, exchanging their operational support and billing capability for favorable wireless resale terms.

**Table 6: Top Ten Markets C Block Results Compared to A/B Block Results**

Market	# of BTA Pops (000s)	High Bid (\$ mil)	Price per Pop	Corresponding MTA Pops	Translated Value of A/B	Actual Avg. Price A/B	% Difference
New York	18,051	\$994.1	\$55.07	26,411	\$1,454.5	\$442.7	228.5%
Los Angeles	14,550	\$663.5	\$45.60	19,145	\$873.1	\$493.5	76.9%
Chicago	8,182	\$461.0	\$56.34	12,070	\$680.1	\$385.1	76.6%
San Francisco	6,421	\$403.3	\$62.80	11,891	\$746.8	\$206.5	261.6%
Philadelphia	5,899	\$320.2	\$54.29	8,928	\$484.7	\$85.0	470.2%
Dallas	4,330	\$291.0	\$67.21	9,694	\$651.6	\$88.4	636.7%
Washington DC	4,119	\$235.9	\$57.28	7,778	\$445.5	\$211.8	110.4%
Boston	4,134	\$231.2	\$55.92	9,453	\$528.6	\$46.6	1034.9%
Miami	3,270	\$200.0	\$61.15	5,137	\$314.1	\$131.7	138.5%
Houston	4,054	\$198.5	\$48.96	5,191	\$254.1	\$83.9	202.9%
		\$3,998.8			\$6,433.0	\$2,175.2	195.7%

### **AirTouch Launches CDMA Cellular Service**

*CDMA technology offers clear, more reliable calls, increased fraud protection, longer talk time, and enhanced services*

On May 14th, ATI announced that it will begin rolling out CDMA technology in Northern Los Angeles. We believe this positions ATI as one of the premier global wireless companies. The ability to offer a range of services that meet the needs of all of its customers, from the low-end casual user to those seeking premium services, will likely enhance ATI's customer acquisition and retention. This should translate into higher revenue and cash flow growth. CDMA technology offers key benefits to its customers including clearer, more reliable calls, increased fraud protection, longer talk time, and enhanced services such as short messaging. ATI is targeting 80% coverage of its Los Angeles market by year-end 1996, with complete coverage by March 1997. In addition, it plans to rollout digital service to all of its markets (including those associated with its merger with U S West Media) within two years. ATI chose CDMA over other digital technologies for its higher capacity, greater benefits to carriers and customers, growing worldwide acceptance (with 18 countries having adopted CDMA or considering it in some capacity), and its potential as a long-term platform for growth, allowing a single transition to digital service.

We believe ATI is acting prudently in its strategic rollout of the *PowerBand* service in Los Angeles, initially targeted to its high usage customers (i.e., those with several hundred minutes of use per month) and for the first six months at least will be sold through ATI's direct salesforce. We see several benefits to this approach for ATI including: (1) lower capital investment by moving the highest number of minutes in the shortest amount of time; (2) the elimination of the need for heavy advertising and promotional expense; (3) the promotion of *PowerBand* as a brand name for its premium service; and (4) increased loyalty and customer retention of ATI's best customers. In addition, by offloading these customers from its analog network, ATI frees capacity for its other customers.

## The Internet: The Future of Telecommunications?

*The Internet is a collection of thousands of interconnected computer networks using a common and open communications protocol*

Over the past year, the contribution to growth in the telecom industry and respective companies stemming from the explosion in Internet commercialization has been noteworthy. As background, the Internet is a global collection of thousands of interconnected computer networks which use TCP/IP (Transmission Control Protocol/Internet Protocol), a common and open communications protocol. Basically the Internet is an overlay on existing telephone networks consisting of local loops and distribution, switches and long distance lines, supported by tandem switches, servers, routers and computer modems to server software and browsers. The origination of the Internet stems back to 1969 as a project for the Department of Defense to develop an efficient and reliable long distance data network among disparate computer systems used by government-funded organizations. In the 1980's the National Science Foundation (NSFnet) built connections between these networks and in 1991 the Internet became commercialized. At the end of April 1995 federal funding ceased and the NSF turned control of its Network Access Points (NAPs) over to private companies (Ameritech, Sprint, Pacific Telesis and MFS Communications). NAPs are the junction where Net traffic transfers from one carrier's backbone to another's.

By any measure – Internet Users and World Wide Web Users – the Internet's growth, particularly in the two years following its commercialization, has been phenomenal. It is expected to continue its acceleration, paralleling the rapid growth in the on-line services, e-mail and corporate intranets

*The telecom industry has viewed the growth of the Internet as both a threat and an opportunity*

The strong Internet growth has caught the attention of the telecom industry viewing it as both a threat and an opportunity. On the one hand the Net has created demand for traditional voice-based networks, though longer-term Net services can result in diminished revenues if substitute services such as e-mail replaces voice and voice-messaging. Demand for Internet access is stimulating growth for the telecom industry, resulting in robust additional customer line gains in the residential and small business markets as users prefer two paths, one for traditional voice and one to accommodate Net use. Most large telcos have deployed large SONET rings in their business

districts. They make higher speeds and capacity available on demand to their business customers, providing T1 or DS1 capacity, which carry 1.5 megabits and T3 or DS3 capacity with 45 megabits. However, at this juncture the RHCs are restricted in carrying long distance traffic. For their consumer segment the large telcos have begun deploying digital ISDN lines, medium speed capacity lines capable of 128 kilobit speeds for voice, data, and video.

Currently, transfer rates are a barrier to the growth of Internet use but Internet-friendly technologies – ISDN, ADSL – will eliminate the limitations. From the telco point of view the current 14.4-28.8 Kps modem standard connected to the POTS (plain old telephone service) is OK for some applications, but slow. The long distance carriers, notably WorldCom, MCI and Sprint supply much of the backbone network and are expanding capacity to higher levels (e.g., MCI is tripling its Internet capacity 45 Mbps to 155 Mbps).

## A Glance at First Quarter 1996

The first quarter earnings reports provided a positive glimpse at strong fundamentals across most, if not all subsegments. Across nearly every sector, internally generated revenue and earnings growth exceeded expectations, with most of the gains occurring in new services. Highlights from the individual segments were as follows:

***Large telcos experienced strong revenue and volume growth as demand for second lines and new services increased***

**Telcos.** Average first quarter per-share operating earnings for the large telcos rose over 12% year to year. The earnings gains reflected improved trends in telco operations, with benefits from vertical services and cost controls, partially offset by dilution from diversification efforts here and abroad. Each of the Telcos posted operating earnings growth, with **U S West Communications** posting the smallest (3.4%) and **SBC Communications** the largest (17.0%). Revenue growth was fueled by demand for access lines, particularly second lines. Total RHC access line growth was an impressive 4.2% year to year, up from 3.8% in the fourth quarter, while business lines increase 6.8%. Furthermore, total industry minutes of use was up 10.9%, in part due to this winter's severe weather. **GTE** again outpaced the RHC averages, accelerating its growth in total domestic lines to 6.6%.

***Long distance companies saw across-the-board increases in revenue and traffic, particularly wholesale and international***

**Long Distance.** Revenue growth for the big three long distance companies averaged 11.2% year to year on 15.4% annual volume gains in the first quarter 1996, with strong growth from **MCI Communications** (14.1% and 21.3% revenue and volume growth, respectively.) **AT&T's** long distance volume growth (7.7%) was below the industry average, but should improve throughout 1996 as it increasingly bundles its broader service offering to include DirecTV and WorldNet. **Frontier** and **WorldCom** each generated significantly higher revenue and volume growth than the big three due to a greater proportion of wholesale traffic. Although the wholesale revenues typically result in higher negative gap, WorldCom saw a narrowing and relatively modest gap due to higher international traffic, which carries a higher revenue per minute.

Table 7: Long Distance Revenue/Volume Growth Forecast

Company	2Q95			1Q96			4Q95			1Q96		
	Y-to-Y Revenue Growth	Y-to-Y Volume Growth	Gap	Y-to-Y Revenue Growth	Y-to-Y Volume Growth	Gap	Y-to-Y Revenue Growth	Y-to-Y Volume Growth	Gap	Y-to-Y Revenue Growth	Y-to-Y Volume Growth	Gap
AT&T	4.9%	9.2%	-4.3%	5.1%	10.1%	-5.0%	5.1%	10.1%	-5.0%	5.4%	9.7%	-4.3%
Sprint	4.8%	8.7%	-3.9%	2.4%	7.4%	-5.0%	2.4%	7.4%	-5.0%	14.2%	17.3%	-3.1%
MT	12.1%	14.6%	-2.5%	4.1%	10.1%	-6.0%	4.1%	10.1%	-6.0%	14.1%	21.1%	-7.0%
WorldCom	18.6%	36.2%	-17.6%	7.8%	26.1%	-18.3%	7.8%	26.1%	-18.3%	18.6%	22.5%	-3.9%

Note: Frontier is not included given its numerous acquisitions in prior periods, rendering apples-to-oranges comparisons.

**While subscriber gains were strong, companies are focusing on reducing churn and acquisition costs**

**Wireless.** Cellular subscriber gains year to year remained strong, at over 34% in the first quarter. We expect to see an increase in net additions going forward, but also a better balance between subscriber growth and profitability as companies focus on reducing churn rates and acquisition costs. **AirTouch** continued to exhibit strength in its domestic cellular operations, with 43.8% subscriber growth, and 45.2% operating cash flow margins, the highest in our universe. Importantly, the recently enacted Telecom Act of 1996, which allows cellular providers to offer long distance services, has already begun to impact cellular services. **SBC Communications**, for example, signed up approximately 350,000 of its cellular customers for long distance service, which is expected, though only modestly, to increase revenues and should have a greater impact on customer retention.

**The CAPs produced expected negative operating cash flows as they continued their aggressive network expansions**

**Competitive Access Providers.** Both **MFS Communications** and **Intermedia Communications** generated accelerated revenue growth in the first quarter with negative operating cash flow margins, characteristic of high-growth companies in expansionary modes. Operating cash flow losses for MFST were slightly larger than we expected, though the overall downward trend continues. Operating cash flow losses at ICLX reflected its aggressive network expansion plans throughout the Southeast. While higher expenses associated with network expansion plans will result in cash flow losses through most of 1997 until breakeven in the fourth quarter, positive results should then ramp-up quickly.



## Ameritech (AIT)

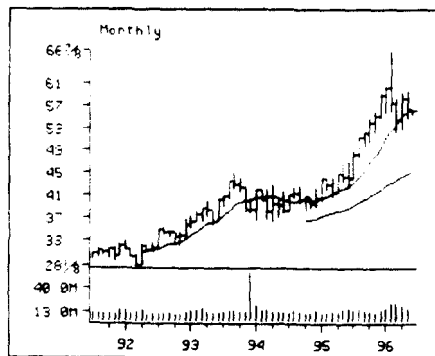
**Rating: Buy**

Price	52-Week Range	Earnings Per Share			P/E		Divd	Yield
		12/95A*	12/96E	12/97E	12/96E	12/97E		
56 1/2	67-42	\$3.41	\$3.80	\$4.20	14.9	13.5	\$2.12	3.8%

\* Operating EPS

### Highlights

**Operating EPS 2Q96E \$1.01  
versus \$0.91 in 2Q95**



Courtesy of ILX

- **Accelerating double-digit growth in core revenues (excluding acquisitions) and EPS in the first quarter 1996 raises our confidence about sustainability.** AIT delivered double-digit earnings growth above our expectations on higher-than-expected revenues, up 13.4% year to year, and exceeding 10% absent the security monitoring business acquired in 1995. The growth is coming from: above-average volume trends in all of its businesses, new service generation, reduced rate cuts, and strong wireless operations.
- **Raising our estimates, which reflect expectations for continued strong fundamental growth.** We are raising our 1996 and 1997 EPS estimates by a nickel, reflecting our expectations for AIT to at least meet, if not exceed 10% earnings growth targets through strong internal revenue growth, which are now reaching double-digit rates. The strong revenue growth is based on: relatively strong volume trends in its traditional businesses; benefits from a greater exposure to faster growing businesses, notably security monitoring, and an influx of contract contributions; no contribution from long distance entry; and only modest price reductions. We also expect some market share declines from the opening of intralata toll markets in Illinois and 10% of its Michigan market on a 1+ dialing basis (in our forecast), but note that AIT is competitively positioned in its price and cost structure relative to its peers to minimize losses.
- **With this outstanding quarter, which follows AIT's positive strategic implementation, AIT is in a leadership role in setting a new pace for growth.** We point to this quarter as the result of strong strategic planning and execution that will be beneficial as the telecom market competition intensifies, enabling AIT to more than offset share loss with expanded growth.
- **Reiterate our Buy.** With the AIT shares down 17% from their recent highs (recorded following well-deserved optimism regarding the group's overall fundamental strength for the foreseeable future), we reiterate our Buy rating. We view AIT as favorably positioned to grow earnings at the high end of the large telco group through its internal strength and entry into new markets – security monitoring, new information services contracts, long distance, and video – based on its reduced cost structure and differentiated strategy. We believe the AIT shares deserve a premium valuation given their consistent double-digit EPS growth and strong dividend growth, evidenced by a recent healthy hike, yet currently trade at a discount to its peers. We point to our six- to twelve-month

price objective of mid-range price based on a 10% premium to the market multiple of 20x earnings.

## Investment Position

AIT reported first quarter operating earnings of \$0.86, ahead of \$0.84 estimate and a 13.1% increase from the year-earlier operating earnings of \$0.76. First quarter 1996 operating earnings were relatively clean, while the \$0.76 per share from first quarter 1995 is before a \$0.29 per share net settlement gain associated with a lump-sum pension payment.

Ten percent internally generated revenue growth coupled with the strong and consistent operating earnings gain in first quarter 1996. Overall, AIT's strong first quarter 1996 EPS growth was the result of: (1) strong volumes in its telco and wireless operations; (2) higher revenue growth, inclusive of more modest price reductions associated with its price regulation plans throughout its region which will continue to trend down from a total of \$200 million in 1995 to \$60 million in 1996; and (3) a 7% improvement in productivity based on the highest (377) access lines per network employee or the lowest telco employees (26.5) per 10,000 access lines, likely to improve in 1996 based on further workforce reductions.

## First Quarter Highlights

Total access line growth was 4.5% year to year, in line with the 4.5% annual gains recorded in fourth quarter 1995. Business line gains outpaced the total year-to-year growth, climbing 7.3%, up slightly from the 7.1% fourth quarter 1995 level. Residential gains were in line with the prior quarter's growth rate, at 3.1% year-to-year growth. Second lines are becoming a bigger contributor to the total access line growth, accounting for about one-half of the year-to-year growth in total lines in the quarter, similar to fourth quarter 1995.

Access minutes grew 10.5% year-to-year in first quarter 1996, above the 9.1% minutes growth recorded in fourth quarter 1995. Intrastate access minutes grew even higher, 13.1% on a year-to-year basis versus 11.3% in fourth quarter 1995. Part of the strength in intrastate minutes growth can be attributed to toll volume taken by competitors translating into access minutes for AIT. Nevertheless, toll message volume was up 6.8% in first quarter 1996 year to year, versus 5.3% growth in fourth quarter 1995.

AIT generated strong cellular subscriber gains year to year of 42.7% in first quarter 1996 versus our expectations of 41% growth. Growth in first quarter 1996 remained relatively stable with the 45.6% growth exhibited in fourth quarter 1995, and importantly reflected a 14.3% year-to-year gain in net adds versus the 11.3% we expected for AIT. AIT added 152,000 net cellular customers in first quarter 1996 versus 217,000 in the seasonally high fourth quarter 1995. AIT now offers over 300,000 of its cellular customers with long distance service, as allowed under legislation. We believe that AIT generated minimal revenue generated in this quarter from cellular long distance, but expect that it is gaining the benefit of customer retention and stable margins. AIT management shared monthly churn rates of less than

1%, about the best in the industry; we estimate the industry average to be 1.5%-2%. The stronger growth here helps to confirm that AIT has become quite competitive in the cellular markets. While AIT does not share details from this segment, AIT management said the company experienced modest decline in monthly revenue per subscriber to \$50-\$55, below the \$55-\$60 in fourth quarter 1995.

Total operating revenues grew a robust 13.4% year-to-year in the first quarter, above the 11% rate experienced in the previous quarter. We would point out that even without its security monitoring business, acquired in 1995, AIT generated double-digit revenue growth in the quarter. In addition, local revenues grew by 10%, the highest we have seen, in part due to the reduced rate cuts. First quarter revenues were inclusive of only modest incremental revenue reductions required as part of its pure (no sharing of earnings) price cap plans. We do not expect that AIT will reflect material revenue reductions going forward, targeting only about \$60 million in 1996.

Total revenue growth was outpaced by the 13.8% gain in total operating expenses in the first quarter 1996, normalizing for a one-time pension settlement gain in the first quarter 1995. A 26.4% increase in other operating expenses was due its security monitoring business and video expenses. AIT is maintaining a relatively high advertising budget which could increase during 1996 as reflected in the current quarter. AIT is seeing lower costs associated with cable/video construction where AIT now has 14 franchises covering about 200,000 homes within its region. Depreciation remained high in the quarter with a 9.0% increase year to year, similar to fourth quarter 1995's 8.5% increase. The telco workforce has declined 2.0% year to year and will continue to decline in 1996, although the decline will be more than offset by additional employees for its video, and long distance initiatives.

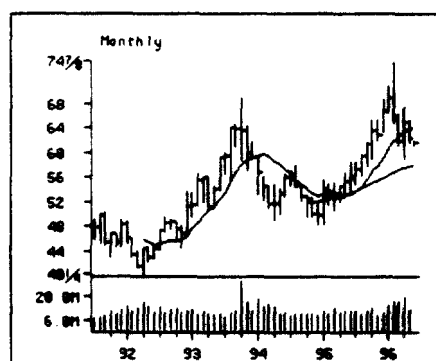
# Bell Atlantic (BEL)

**Rating: Buy**

Price	52-Week Range	Earnings Per Share			P/E		Divd	Yield
		12/95A*	12/96E	12/97E	12/96E	12/97E		
62 <sup>1/2</sup>	75-53	\$3.88	\$4.30	\$4.70	14.5	13.3	\$2.88	4.5%

\* Operating EPS

**Operating EPS 2Q96E \$1.12  
versus in \$1.02 in 2Q95**



Courtesy of ILX

## Highlights

- **Better-Than-Expected EPS; maintaining estimates.** BEL reported first quarter 1996 operating EPS of \$1.07, ahead of our \$1.06 estimate, and 11.6% above the first quarter 1995 \$0.95 operating EPS. We note that the current quarter is relatively clean and is inclusive of anticipated dilutive effects (about a nickel in first quarter 1996) for expanding businesses, including about \$0.02-\$0.03 for PCS and global and \$0.02 for Tele-TV, its video joint venture. We are maintaining our 1996 and 1997 EPS estimates of \$4.30 and \$4.70, respectively, which are at the high end of consensus. The EPS increases reflect increased confidence in management's ability to target growth opportunities, offsetting expected dilutive effects of fledgling businesses, higher marketing costs and the competitive pressures on pricing.
- **Strong volume and revenue trends in telco and cellular, with higher margins lead to a strong 1996 and 1997 earnings outlook.** We believe the strong quarterly results indicates that BEL management is running ahead of its growth targets for the year and provides a strong fundamental platform for future earnings growth for the long term
- **Merger with NYN is a possible and positive development.** A BEL/NYN merger is a powerful combination as companies prepare for competition as well as growth opportunities by creating improved scale economies. We do not believe a higher premium should be paid for NYN shares from such a combination given that (1) at current levels the NYN shares already reflect a premium to the BEL shares benefiting from heightened speculation; and (2) largely different circumstances than the SBC/PAC announced merger, which contained a premium for PAC's depressed shares. PAC/ SBC did not have previously combined assets such as the BEL/NYN wireless joint venture.

## Investment Position

We reiterate our Buy recommendation and point to our twelve-month price target of \$75. At current levels the BEL shares are down about 17% from their recent high, with its valuation in part impacted by investor concerns about the merger calling for a premium for the NYN shares. This has resulted in the BEL shares trading at a discount to the NYN shares as well as the group. Given the strong quarter and anticipated strong long-term fundamental platform for growth, we strongly reiterate our Buy recommendation of the BEL shares. We believe that BEL deserves a 10% premium to the market given its solid double-digit earnings growth and recent 2.9% dividend hike. We continue to believe that BEL's long-term

## First Quarter Highlights

**We are maintaining our 1996 and 1997 earnings estimates of \$4.30 and \$4.70, respectively, at the high end of consensus, which reflect our confidence in the strength of BEL's operating levels and its competitive position in its core markets. Although BEL will be facing increased open local markets (1+ dialing is slated to begin in New Jersey and Pennsylvania in 1996-97), BEL has been aggressively reducing its prices to more competitive levels (\$0.02 per access minute; less than \$0.08 per toll minute) and to stimulate market demand for new services (ISDN pricing is among the lowest in the country accounting for BEL's leadership in absolute number of higher speed ISDN lines). Our estimates reflect continued strong growth in core business in excess of 10%, offset by about \$0.15-\$0.20 per share of dilutive effects for start-up businesses, specifically: its 25% share of the PCS PrimeCo venture which is targeting a second half ramp up of operations; costs relate to its international businesses (interest in Omnitel, its Italian cellular venture, Iusacell in Mexico); and starting up its long distance (mid 1997 entry) and video businesses.**

34

inches of line. This growth is due to increased marketing efforts that has made ISDN pricing more affordable and attractive.

**Total minutes growth a robust 12.7% year to year in the first quarter compared to 8.2% year-to-year growth in the fourth quarter.** The materially higher growth in the quarter is benefiting from strong DS1 and DS3 lines (high speed data lines) and is in part associated with severe winter weather driving up usage. Interstate access minutes grew 10.3% in first quarter 1996 compared to 6.8% growth in fourth quarter 1995, while intrastate access volume jumped 21.8% compared to 13.5% growth in fourth quarter 1995. Toll message volume improved 7.7% in first quarter 1996 up from an increase of 1.8% in the fourth quarter which had marked a reversal in toll message declines with toll share having stabilized. Toll volume reflects: (1) weather-related calling; (2) the impact of intralata toll competition in New Jersey, which has begun to stabilize; and (3) the redefined toll areas to expanded local calling areas. It is worth noting that for every dollar of revenue loss due to toll, BEL recoups about 70% of it in access revenues.

**Wireless results reflect strong volume, revenue, cash flow growth and higher margins that place the company at the upper end of the industry on most measures.** BEL's equity income from its wireless joint venture with NYN has more than doubled year-to-year, strongly benefiting from the combination significantly lifting the combined cash flow margins. Cellular subscribers at BEL/NYN Mobile increased a healthy 41.9% in first quarter 1996 relatively stable with the 43.4% year to year growth in fourth quarter 1995, and at the upper range of the industry. Sequential growth was a healthy 6.5% with net additions in the quarter, at 217,000, growing 21.7% year to year. This is well above our expectations for 195,000 net additions in the quarter. BEL/NYN Mobile's penetration stands at 6.4%, compared to 4.5% a year ago. **Cellular revenues, before equipment, grew 29.6% year to year, slightly better than the 27.3% growth in fourth quarter 1995, despite a 6.6% sequential reduction in monthly revenues per subscriber.** Monthly revenue per subscriber was \$57 in first quarter 1996, down 8.1% from \$62 in first quarter 1995 and \$61 in fourth quarter 1995. A big part of the decline in monthly revenues per subscriber is due to its successful "Talk Along" product and a significant part of its wireless subscriber growth, which targets lower usage customers, acquired but at lower costs per gross add and increased profitability. **"Talk Along" subscribers almost doubled in the quarter from the year-end 1995, and now stands at 363,000 customers.**

BEL/NYN Mobile's churn rate increased a bit in first quarter 1996 to 1.9% from fourth quarter 1995's 1.8%, but was stable with first quarter 1995's 1.9% level. This is modestly below the industry average that we peg at just under 2% and anticipated to decline through the year as BANM bolsters its focus here. We note that the first PCS network in the country operated by American Personal Communications (APC), part of the Sprint Spectrum, began service in the Baltimore/Washington DC market in November 1995 and has picked up about 60,000 new wireless subscribers. However, these customers are not churning off of the BANM system due to APC's limited service area and appeal, and in fact have resulted in higher net adds in the

region. We will be watching these developments carefully throughout 1996. BEL/NYN Mobile's acquisition cost per gross add was \$213 up from \$202 in fourth quarter 1995, but down slightly from \$215 in first quarter 1995. We believe this is one of the lowest costs in the industry, benefiting from management focus and new product introduction (i.e., "Talk Along"). The increase in cost per gross add has translated into cash flow margins of 41%, compared to 44% in fourth quarter 1995, although it is greatly improved from the 29% in first quarter 1995.

**Total operating revenues in the first quarter increased 5.3% adjusted for the discontinued Business Systems Services** sold in October 1995 which was not considered strategic to the company. The year-to-year increase in revenues includes a slight increase in toll revenues (0.7%) which reverses the trend of year-to-year declines in toll revenues throughout 1995. Although the increase is partly due to higher toll volume associated with severe winter weather offsetting discounted pricing plans, it also reflects a stabilization of toll erosion. The bulk of the revenue growth comes from network services, up 5.7% year to year, inclusive of modest incremental price cuts for interstate services implemented on August 1 offset by reduced sharing obligations. This growth is ahead of BEL's targeted 5.0% revenue growth for the year and a good indication of sustainability. Network service revenue growth is due to better telco volumes, helped by second line growth, and increased penetration from vertical services with revenues from Answer Call (voice messaging) and Caller ID up 23% year to year. Penetration of these services is currently in the 12% range. Value-added revenues were up 13.8% year to year, with two-thirds of growth coming from caller ID and other call management features and one-third from Answer Call, its voice messaging service.

**Total operating expenses were up 6.4%, normalized for discontinued Business Systems Services.** Strong cost containment efforts, were offset by higher costs for new billing systems, software upgrades, and marketing expenses associated with newer and expanding businesses, specifically video and long distance, which will be ongoing. BEL, among the leanest telcos, continues to excel in cost reductions. Total employee costs are down almost 1% year to year in the current quarter; the telco workforce is down 6.5% year to year and stands at 27.8 telco employees per 10,000 lines, a 9.7% improvement from the 30.8 telco employees per 10,000 lines a year ago. BEL is more than halfway through with its plan to reduce its telco workforce by 5,600, with the rest expected to be completed by year-end 1996. While employee levels BEL's network operations will continue to fall, we expect additional employees for new initiatives such as video and long distance. We expect BEL to continually scrutinize its operations for the leanest workforce though keeping customer service quality high.

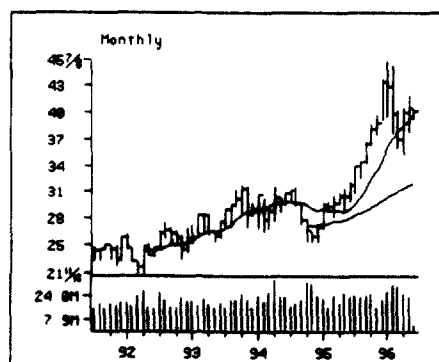
# BellSouth (BLS)

**Rating: Hold**

Price	52-Week Range	Earnings Per Share			P/E		Divd	Yield
		12/95A*	12/96E	12/97E	12/96E	12/97E		
40 <sup>3/4</sup>	46-29	\$2.24	\$2.50	\$2.75	16.3	14.8	\$1.44	3.5%

\* Operating EPS, after 2:1 stock split

**Operating EPS 2Q96E \$0.62  
versus \$0.56 in 2Q95**



Courtesy of ILX

## Highlights

- **Operating EPS above expectations; Raising estimates.** BLS reported first quarter 1996 operating EPS of \$0.63 before a one-time gain on the sale of its paging operations, above our \$0.60 estimate, and 14.6% above the \$0.55 operating EPS in first quarter 1995. We are raising our 1996 and 1997 estimates by a nickel, to \$2.50 and \$2.75, respectively, on expectations for low double-digit earnings growth for the rest of the year.
- **Strong revenue and volume trends in its telco and cellular businesses drove earnings in the quarter.** BLS's telco results, enhanced by second access lines and vertical revenue growth, were strong, while cellular subscriber growth, at 31% year to year, exceeded expectations. BLS's strong 7.7% revenue growth drove earnings despite higher marketing costs than a year ago for positioning BLS in the new competitive environment.
- **Maintain Hold rating.** We believe the BLS shares should trade at a modest premium to the market multiple on 1996 EPS reflecting expectations for double-digit growth. Our price target is \$42-\$43, indicating a potential price appreciation of about 11%, not enough to warrant a Buy rating.

## Investment Position

Blessed with a strong Southeastern economy, BLS registered above-average volume growth in its telco operations, and will benefit from reduced sharing accruals now that a majority of its telco revenues are under price regulation providing BLS with greater earnings flexibility. On the other hand, we expect BLS will begin to experience increased competition in some of its markets, notably Atlanta and Florida. Although BLS is improving its costs structure through an expanded workforce reduction plan targeting 11,300 employees by year-end 1997, it still lags its peers. BLS has a fairly aggressive diversified strategy including a cellular presence outside of its telco region, mobile data (an interest in RAM Broadcasting), a stake in Optus (a full service provider in Australia), and extensive Latin American cellular interests. BLS generates above-average results from its wireless businesses, however, not all of its businesses are home runs. Based on a modest premium to the market P/E on our revised 1996 earnings estimate, we see limited upside to the \$42-\$43 range for BLS shares. We therefore are maintaining our Hold rating.



## First Quarter Highlights

BLS's first quarter operating earnings of \$0.63 per share, were above our expectations of \$0.60 per share, and 14.6% above the previous year's \$0.55 operating earnings. The operating EPS in 1Q96 is before a one-time gain of \$0.35 per share related to the sale of its paging business in October 1995, while 1Q95 was a relatively clean quarter. This quarter's results reflected strong revenue and volume growth in its core telco and cellular businesses, offset by higher expenses, notably for marketing. Operating earnings per share growth in 1Q96 was 14.6%, above the 9.6% growth experienced in the previous quarter. The quarter included 7.7% total revenue growth, normalized for the sale of its paging assets, with good operating trends, notably: (1) strong volume growth in its telco business, particularly in second lines; (2) a 27% increase in domestic cellular revenues and a 35% increase in domestic cellular net income, and (3) an acceleration of higher-margined revenues from vertical services such as Caller ID and custom calling features, up 21.1% year to year to \$220 million in the quarter. Offsetting these trends were a 26.3% decline in toll service, as the company continues expand its local calling areas, higher marketing expenses, and a \$4 million net loss associated with currency devaluation in its Venezuelan cellular interest.

**Most telco volume measurements were above the 4Q95 level.** Total access line gains were a robust 4.8% in 1Q96, well above the 4.5% level achieved in 4Q95, and at the high-end for the group. Business access line gains were higher at a 7.9% annualized rate, with particular strength in Georgia (9.0% vs. 8.9% in 4Q95), and Florida, Tennessee and Kentucky (8.1%). Residential access line growth was 3.5% in 1Q96, compared to 3.2% in 4Q95, with the strongest growth in Georgia (4.9% vs. 4.4% in 4Q95) and North Carolina (4.0% vs. 3.9% in 4Q95). **Importantly, second lines increased 22.9%, reaching 1.35 million lines for a 10% penetration rate.** Revenues generated from second access lines totaled \$100 million in 1Q96.

**Total minutes grew by 10.8%, above the 9.0% growth in 4Q95.** Year-to-year growth in intrastate minutes was particularly strong at 13.0% in 1Q96, and about in line with the 13.1% growth registered in 4Q95. Interstate minutes of use grew 10.1% in 1Q96, compared to 7.7% in 4Q95. The growth in minutes of use is the result of a greater number of access lines and reduced toll volumes which are translating into higher intrastate access minutes for the RHC's.

**Toll message volume was down 24.1% year to year in 1Q96,** compared to a 16.8% decline in 4Q95, mostly due to the expansion of local area calling plans, which accounted for about 70% of the drop with competition accounting for the remaining 30%.

**Domestic cellular subscribers (on an equity basis) grew 31% year to year and nearly 7% sequentially, with almost 198,000 subscribers added in 1Q96.** The 31% subscriber growth is about in line with the 32% year-to-year growth recorded in 4Q95. Penetration increased to 7.6% in 1Q96 from